

Federal Preemption Issues in Banking

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Issue

Explain federal preemption of state banking laws that address interest limits, account charges, gift card fees, and certain other topics. This report updates OLR report [2010-R-0025](#).

Summary

Federal law generally preempts state laws that regulate banking, including laws regulating issues such as interest rates, account fees and charges, ATM fees, gift card fees, branching, and the sale of insurance.

State laws on the following issues are generally not preempted: contracts, torts, criminal law, debt collection rights, property acquisition and transfer, and taxing and zoning.

Federal Preemption

Regulatory Entities

In general, three federal entities regulate national financial institutions and may issue preemption orders.

Federal Preemption

Generally, federally chartered banking institutions are governed by the National Bank Act and other federal laws that preempt state law.

States may legislate national banks directly in areas specifically allowed by federal law or indirectly through laws of general applicability. For more information, see [OLR Report 2017-R-0018, Issue Brief: Federal Preemption and Oversight in Banking](#).

This report considers only banking institutions, and does not contemplate oversight or preemption of securities and investment institutions or credit unions.

The Office of the Comptroller of the Currency (OCC). The [OCC](#) charters and regulates (1) national banks, (2) federal branches and agencies of foreign banks, and (3) federal savings associations ([12 U.S.C. § 1813\(q\)](#)). (Federal branches and agencies of foreign banks are generally bank branches or agencies that are organized under the laws of a different country but operate in the United States ([12 U.S.C. § 3101](#)).)

The Federal Reserve Board (FRB). The [FRB](#) regulates the activities of its member banks and institutions, which generally include state member banks, branches or agencies of foreign banks and uninsured foreign banks, commercial lending companies or agencies other than federal agencies, bank holding companies and subsidiaries, and savings and loan companies and subsidiaries ([12 U.S.C. § 1813 \(q\)\(3\)](#)). National banks must also be members, but as mentioned earlier, they [are regulated](#) by the OCC.

The Federal Deposit Insurance Corporation (FDIC). The [FDIC](#) regulates state banks that are not federal reserve members, foreign insured banks, and state savings associations ([12 U.S.C. § 1813 \(q\)\(2\)](#)). It also insures deposits of all federally chartered institutions and any qualified state-chartered institutions. To obtain deposit insurance, banks must observe the FDIC's safety and soundness rules.

Preemption Opinions or Interpretations

Federal law grants the OCC, FDIC, and FRB the authority to decide whether federal laws governing national banks preempt state laws ([12 U.S.C. § 43](#)). After making such a decision, the regulating entity must issue a preemption opinion or interpretation.

A state consumer financial law is generally preempted by federal law if it has (1) a discriminatory effect on national banks in comparison to state banks, (2) prevents or significantly interferes with a national bank's exercise of its powers, or (3) is otherwise preempted ([12 U.S.C. § 25b](#)).

Before issuing a preemption opinion or interpretation, these federal agencies must first:

1. publish notice of the opinion, including a description of the state law, in the *Federal Register*;
2. give interested parties at least 30 days to submit written comments; and
3. consider any comments received in issuing the final preemption opinion or interpretation ([12 U.S.C. § 43\(a\)](#)).

With certain exceptions, the regulating entity must publish in the federal register any final opinion or interpretation about:

1. community reinvestment,
2. consumer protection,
3. fair lending,
4. the establishment of a national bank's intrastate branches, or
5. determinations that a state law would discriminate against national banks ([12 U.S.C. § 43\(b\)](#)).

In emergency situations, the regulating entity may issue preemption opinions or interpretations without going through the procedural steps listed above. In such a case, it must determine, in writing, that the exception is necessary to avoid a serious and imminent threat to the safety and soundness of a national bank. The law also allows an exception to the notice and comment requirements if the opinion or interpretive rule is issued in connection with an acquisition (1) of one or more banks in default or danger of default or (2) in which the FDIC provides assistance ([12 U.S.C. § 43\(c\)](#)).

Examples of Banking Issues Preempted by Federal Law

Interest Limits

Loans and Credit. The National Bank Act (NBA) allows national banks to charge the higher of (1) the rate allowed by the laws of the state where the bank is located or (2) 1% above the federal reserve discount rate for the federal reserve district where the bank is located ([12 U.S.C. § 85](#)) (e.g., most favored lender status).

Interest

The interest that national banks may charge includes certain related fees, such as fees for late payments, insufficient funds, cash advances, or membership ([12 C.F.R. § 7.4001](#)).

This preemption also applies to credit cards issued by national banks, which may charge up to the highest interest allowed in the state in which the card is issued, regardless of the laws of the state where the customer is located (*Marquette Nat'l Bank of Minn. v. First Omaha Serv. Corp.*, 439 U.S. 299 (1978) and *Pacific Capital Bank N.A. v. Connecticut*, 542 F.3d 341 (2d. Cir. 2008)).

Mortgage Loans. National banks may charge interest on real estate loans at the rate allowed by the laws of the state in which the bank is organized, without regard to the laws of the state in which the borrower resides ([12 U.S.C. § 85](#); [12 C.F.R. § 34.4\(a\)\(12\)](#)).

In addition, states may not enact laws that limit interest, discount points, finance charges, or other charges on “federally-related” loans secured by a mortgage ([12 C.F.R. § 190.101](#)).

States may not prohibit adjustable rate mortgages ([12 U.S.C. § 3803\(c\)](#)). However, federal laws allowed states a three year window, from 1982-1985, to opt out of these provisions ([12 U.S.C. § 3804\(a\)](#)). According to Real Estate Finance Law (6th ed.), six states opted out: Arizona, Maine, Massachusetts, New York, South Carolina, and Wisconsin. As a result, with regards to adjustable rate mortgages, it appears non-federally chartered institutions within these states issuing adjustable rate mortgages are regulated by state law.

States are also preempted from prohibiting any lender, including state-chartered banks, from including due-on-sale clauses in loans backed by residential real estate ([12 C.F.R. § 191.1](#)). “Due-on-sale clauses” generally require a borrower to pay the full amount of the loan immediately upon selling the real estate that backs the loan.

Account and ATM Charges and Fees

NBA authorizes national banks to charge consumers non-interest charges and fees, including deposit account service charges ([12 C.F.R. § 7.4002](#)). State laws that attempt to limit or prohibit such charges and fees are subject to preemption as determined by the OCC ([12 C.F.R. § 7.4002\(d\)](#)). In general, courts have upheld OCC determinations of federal preemption (e.g., *Bank of Am. v. City of County of San Francisco*, 309, F. 3d 551 (9th Cir. 2002) and *Monroe Retail v. RBS Citizens, N.A.*, 589 F3d 274 (6th Cir. 2009)).

Federal law does not limit these fees, but requires they be established according to “safe and sound banking principles.” In setting these fees, a national bank must consider, among other things, its (1) cost for providing services and deterring the misuse of such services, (2) competitive position, and (3) financial safety and soundness ([12 C.F.R. § 7.4002\(b\)](#)).

Gift Card Fees

Gift cards are generally regulated by the federal Electronic Fund Transfer Act (EFTA), which preempts any inconsistent state laws regarding (1) electronic fund transfers; (2) dormancy, inactivity, or service fees; or (3) card expiration date ([12 C.F.R. § 1005.12](#)). EFTA generally applies to gift cards, gift certificates, and other general-use prepaid cards (i.e., cards issued on a prepaid basis primarily for personal use and redeemable at unaffiliated merchants) ([12 C.F.R. § 1005.20\(a\)](#)).

However, state laws are only preempted if they are inconsistent with federal law, and then only to the extent of the inconsistency. A state law is not inconsistent if the protection it affords consumers is greater than the protection afforded by EFTA and it meets certain other criteria (15 U.S. Code § 1693q). As such, state laws are not preempted if they (1) are substantially similar, (2) have adequate enforcement provisions, and (3) meet or exceed EFTA's consumer protection provisions ([12 C.F.R. § 1005.12](#); [15 U.S.C. § 1693r](#)).

Branching

States have control over where a state-chartered bank can open a new branch, although Connecticut currently has no geographic limits. National banks, on the other hand, need the OCC's approval to open a branch. Federal law generally prevents the OCC from approving a branch where a state-law would prohibit a state-chartered bank to operate ([12 U.S.C. § 36\(c\)](#)).

At least one court has held that national banks do not need the OCC's approval to establish or shut down branch ATM's and are not prevented from establishing ATMs where state laws would prohibit them (*Bank One, Utah v. Guttau* 190 F3d 855 (8th Cir. 1999)).

Connecticut is one of 48 states that have "opted in" to interstate branching under the federal Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. This act allows a single bank to operate branches in more than one state without requiring separate capital and corporate structures for each state. The act also subjects out-of-state national banks to the host state's laws concerning community reinvestment, consumer protection, fair lending, and establishing intrastate branches. Branches are subject to the host state's laws in these categories to the same extent as they apply to banks chartered in that state except when preempted by federal law or when the OCC determines that applying a state law would discriminate against an out-of-state national bank's branch ([12 U.S.C. § 36\(f\)](#)).

Visitorial Powers

Federal law prohibits state officials from exercising visitorial powers on national banks, such as conducting examinations, inspecting a bank's books, or prosecuting enforcement actions except in limited circumstances ([12 C.F.R. § 7.4000](#)).

Insurance

A national bank located and doing business in any place with a population less than 5,000 may act as an agent for any fire, life, or other insurance company authorized to do business in the state ([12 U.S.C. § 92](#)). This provision applies even if the principal office of such a bank is located in a community with a population greater than 5,000 ([12 C.F.R. § 7.1001](#)). The U.S. Supreme Court has

held that this provision preempts a state statute that would prevent a national bank from selling insurance in a small town (*Barnett Bank of Marion County NA v Nelson*, 517 U.S. 25 (1996)). Connecticut law allows banks to sell certain types of insurance and annuities directly, indirectly through a subsidiary, or under a contract with third party marketing organizations who sell insurance or annuities on bank premises ([CGS § 36a-250\(a\)\(39\)](#)). In Connecticut, savings banks are authorized by state law to sell savings bank life insurance ([CGS § 36a-285](#)).

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